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August 10, 2010

Members of Council  
Corporation of the Township of Scugog  
P O Box 780  
181 Perry Street  
Port Perry, ON  
L9L 1A7

Dear Sirs/Mesdames:

**Re: Audit of the Financial Statements of Corporation of the Township of Scugog  
For the year ended December 31, 2009**

The purpose of this report is to summarize certain aspects of the audit that we believe would be of interest to the Members of Council. This report should be read in conjunction with the financial statements and our report thereon, and it is intended solely for the use of the Members of Council and should not be distributed to external parties without our prior consent. We accept no responsibility to a third party who uses this communication.

#### ***Auditing and Assurance Standards Board Strategic Plan***

The Auditing and Assurance Standards Board (AASB) has adopted International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). The ISAs, which deal with the audit of financial statements, will be incorporated into the CICA Handbook and will be called "Canadian Auditing Standards" (CASs). CASs will be applicable to all entities.

The CASs will be effective for fiscal periods ending on or after December 14, 2010, and will impact our audit of your entity. Below are some of the key changes that will have the most significant impact:

#### ***CAS 320 - Materiality and CAS 450 - Evaluation of Misstatements***

CAS 320 introduces "performance materiality" to the audit. As you are aware, overall materiality in an audit is used as a guide for planning the nature and extent of audit procedures and for assessing the sufficiency of audit evidence gathered. It is also used in evaluating the misstatements found and determining the appropriate audit opinion to express. Performance materiality will be at 50% to 75% of overall materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. This will have an impact on the amount of work we perform, as the extent of our substantive procedures will be based on performance materiality.



CAS 450 requires that we request correction of all non-trivial misstatements. We will need to obtain from you and document reasons why corrections are not made, and consider these misstatements when determining whether the financial statements are materially misstated. This will help you to maintain accurate accounting books and records and reduce the risk of material misstatements in future periods due to the cumulative affect on uncorrected misstatements related to prior periods.

#### *CAS 560 - Subsequent Events*

This standard requires that the date of our auditor's report is the date which the financial statements have been prepared and those with recognized authority have asserted that they have taken responsibility for those financial statements. This means when, for example, management or those charged with governance have approved the draft financial statements.

This will have an impact on procedures that are linked to the date of our auditor's report such as the following:

- legal enquiry letter: we will likely have to send a letter during field work and perform a follow up with legal counsel once our report date is known.
- subsequent event work: we will likely have to send staff to finish off procedures relating to subsequent events while financial statements are being presented for approval if our staff have left your premises prior to the date of the report.

#### *CAS 700 - The Auditor's Report*

In addition to there being more flexibility in giving opinions on different bases of accounting, there has been a change in the length and structure of the standard audit report.

Gone is the premise that Canadian Generally Accepted Accounting Principles (GAAP) is the only accounting framework acceptable for audit. Soon the premise will be that entity chooses the accounting framework and as long as the framework selected is suitable for the circumstances it can be audited.

Organizations should keep in mind they may have legislative or other requirements to observe which indicate the accounting framework they should follow. In addition organizations should be aware that not every accounting framework is suitable for every circumstance. We can discuss options available to you.

The base wording of the auditor's report will have four paragraphs:

1. The 'Report on the Financial Statements' paragraph describes what we are auditing.
2. The 'Management's Responsibility for the Financial Statements' indicates management is responsible for the preparation of the financials. It also indicates the framework in use.



3. The 'Auditor's Responsibility' paragraph explains our relationship to the financials and what an audit entails.
4. The 'Opinion' paragraph contains our conclusions.

If you have any questions on these new audit standards, we would be pleased to discuss them with you in more detail.

### Responsibilities of the Auditor

It is important for the Members of Council to understand the responsibilities that rest with the municipality and its management and those that belong to the auditor:

- Management is responsible for the preparation of the consolidated financial statements, which includes responsibilities related to internal control, such as designing and maintaining accounting records, selecting and applying accounting policies, safeguarding assets and preventing and detecting fraud and error;
- The auditor's responsibility is to express an opinion on the consolidated financial statements based on an audit thereof;
- An audit is performed to obtain reasonable, but not absolute, assurance as to whether the consolidated financial statements are free of material misstatement and, owing to the inherent limitations of an audit, there is an unavoidable risk that some misstatements of the financial statements will not be detected (particularly intentional misstatements concealed through collusion), even though the audit is properly planned and performed;
- The audit includes:
  - (i) obtaining an understanding of the entity and its environment including internal control in order to plan the audit and to assess the risk that the consolidated financial statements may contain misstatements that, individually or in the aggregate, are material to the financial statements taken as a whole;
  - (ii) examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
  - (iii) assessing the accounting principles used and their application; and
  - (iv) assessing the significant estimates made by management;
- When the auditor's risk assessment includes an expectation of the operating effectiveness of controls, sufficient appropriate audit evidence is obtained through tests of controls to support the assessment, but the scope of the auditor's review of internal control is insufficient to express an opinion as to the effectiveness or efficiency of the entity's controls; and
- We expressed an opinion as to whether the consolidated financial statements presented fairly in all material respects, in accordance with Canadian generally accepted accounting principles, the financial position, results of operations and cash flows of the entity.



### Audit Approach

We were engaged to perform the audit of the consolidated financial statements of Corporation of the Township of Scugog for the year ended December 31, 2009. We adopted an audit approach that allowed us to issue an audit opinion on the consolidated financial statements of the municipality in the most cost effective manner, while still obtaining the assurance necessary to support our audit opinion.

BDO Canada LLP follows a risk based approach. This approach focuses on obtaining sufficient appropriate audit evidence to reduce the risk of material misstatement in the financial statements to an appropriately low level. This means that we focus our audit effort in areas that we believe have a higher risk of being materially misstated and do less audit work in areas that are only low risk.

To assess risk accurately, we need to have a clear understanding of the municipality's business and the environment it operates in. Much of our understanding is obtained through discussions with management and their staff. We appreciate the information that you provided to us about your business, industry, competitive marketplace, internal controls, oversight of management's processes relating to fraud and error, or anything else that you felt was important to the audit as it corroborated what we had already learned from management and other sources, or it may have been new information to us. We also appreciate the insights that you provided to us on what you perceived to be risky in your municipality, including your knowledge of actual, suspected and alleged fraud affecting the entity, as that made our audit more effective and efficient, which benefited all concerned.

The following sections provide more detail on our audit approach for Corporation of the Township of Scugog for the year.

### *Audit Scope*

The scope of our audit of the consolidated financial statements of Corporation of the Township of Scugog for the year ended December 31, 2009 included the following:

- An audit opinion on the consolidated municipality
- Audit procedures on various boards and other entities that were consolidated with the municipality
- An audit opinion on the municipality's Trust Funds
- An audit opinion on the municipality's Business Improvement Area Board
- An audit opinion on the municipality's Library Board



**Overall Audit Strategy**

The general audit strategies available to us are a "combined" audit approach or a "substantive" audit approach.

In a combined audit approach, we would obtain our assurance from a combination of tests of controls (compliance procedures) and substantive procedures (such as analysis of data and obtaining direct evidence as to the validity of the items). The combined strategy is more appropriate when there is a large number of transactions and when controls in the municipality are strong. By obtaining some of our assurance from tests of controls, we can reduce the substantive procedures that need to be done. Under a substantive audit approach, all of our audit evidence is obtained through substantive procedures like analysis, confirmation, examination of documentary or electronic evidence, etc.

Based on our knowledge and experience with your municipality and a preliminary review of your internal controls, we used a combined approach. We tested operating effectiveness of controls in the following transaction streams:

- Purchases, Payables and Payments
- Payroll

Where controls were operating effectively, we reduced our substantive procedures in those transaction streams and the related financial statement areas.

**Higher Risk Financial Statement Areas**

Based on our knowledge of the municipality's business, our past experience, and knowledge gained from management and you, we identified the following financial statements areas as having a potentially higher risk of material misstatement.

These risks arise mainly because of the complexity of the accounting rules, the extent of estimation and judgement involved in the valuation of these financial statement areas, and the existence of new accounting pronouncements that affect them. We have also provided a brief summary of how we audited these higher risk areas.

Higher Risk Financial Statement Areas	Proposed Audit Procedures
<ul style="list-style-type: none"><li>• Post-employment benefit liabilities</li></ul>	<ul style="list-style-type: none"><li>• Examination of calculations and assumptions underlying the liability and communication with the actuary</li></ul>



<ul style="list-style-type: none"><li>• User Fees, Other Revenues, Expenditures</li></ul>	<ul style="list-style-type: none"><li>• Tests to address fraud risk factors; thorough investigation of variances from budget and prior throughout; tests of transactions; analytical review of relationships of financial and non-financial data; comparison of material items in Council minutes to financial records</li></ul>
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**Materiality**

Materiality can be defined as follows:

"A misstatement or the aggregate of all misstatements in financial statements is considered to be material if, in the light of surrounding circumstances, it is probable that the decision of a person who is relying on the financial statements, and who has a reasonable knowledge of business and economic activities (the user), would be changed or influenced by such misstatement or the aggregate of all misstatements. Misstatements in financial statements arise from departures from generally accepted accounting principles and include departures from fact, inappropriate determination of accounting estimates, and omissions of necessary information. Misstatements may arise from error or fraud, or from the consequences of an illegal act." (CICA Handbook S.5142, AuG-41)

Materiality in an audit is used as a guide for planning the nature and extent of audit procedures and for assessing the sufficiency of audit evidence gathered. It is also used in evaluating the misstatements found and determining the appropriate audit opinion to express.

Although we are required to determine materiality based on our perception of the needs of users, it is extremely difficult to predict with certainty who those users will be or, indeed, the specific needs of known users. Consequently, the materiality decision ultimately becomes a matter for the auditor's professional judgment. We have identified Members of Council and long-term debt holders as the most important users of the municipality's financial statements.

Canadian generally accepted auditing standards require the use of both quantitative and qualitative factors in determining materiality. For the audit of Corporation of the Township of Scugog for the year ended December 31, 2009, we have concluded that a materiality level of \$350,000, based on 2% of normalized revenues, and adjusted by qualitative factors such as past audit results, is appropriate for the purposes of the audit.



### ***Reliance on a Specialist***

In order for us to perform adequate audit procedures on certain financial statement areas, we relied on the work of, and the report prepared by, K-W Actuarial Services Inc.. Canadian generally accepted auditing standards require us to communicate with the specialist. We discussed the following with K-W Actuarial Services Inc.:

- The objective and nature of the audit engagement and how we intended to use the specialist's findings and report
- Our assessment of the significance and risk aspects of the engagement that affected the specialist's work
- The requirement to advise us if they have any relationship with the organization which could impair their judgement or objectivity in the conduct of their engagement
- The nature, timing and extent of the specialist's work and our review of it, possibly including review of their working papers
- Confirmation that the assumptions used in their calculations are consistent with those used in the prior periods and with industry standards
- Their obligation to advise BDO Canada LLP of any matters up to the estimated audit report date that may affect their calculations and their report

We asked that the appropriate level of management review the data provided to K-W Actuarial Services Inc. and that they also review the assumptions used and results reported by the specialist for reasonableness.

### **Audit Findings**

There are a number of matters that arose during the audit that we would like to bring to your attention, although none of them resulted in a qualified opinion. Each of these matters is summarized briefly below. We would be happy to discuss any of these items in more detail at our upcoming meeting.

### ***Auditor's considerations of possible fraud and illegal activities***

Our audit procedures were performed for the purpose of forming an opinion on the consolidated financial statements and although they might bring possible fraudulent or illegal activities to our attention, our audit procedures were not designed to detect fraudulent or illegal activities.

We did identify fraud risk factors and they have been discussed with management.

These fraud risk factors indicate that fraud could happen in your municipality. We have communicated these risks to management who will be attempting to set up controls to prevent or detect possible fraud in the future.



In any event, we did not detect any fraudulent or illegal activities, or material misstatements resulting from fraudulent or illegal activities during our audit.

***Litigation Proceedings***

We have communicated with the municipality's legal counsel who have indicated that they are not aware of any material claims outstanding against the municipality.

***Significant Weaknesses in Internal Controls***

We obtained a sufficient understanding of internal controls to enable us to plan the audit. In certain areas, we assessed control risk below maximum and obtained sufficient appropriate audit evidence through tests of control to support that assessment. However, our study and evaluation of internal controls was not sufficient to express an opinion on the effectiveness of the municipality's internal control systems.

Since an audit is not designed to detect all weaknesses in internal controls, there may be other weaknesses which our procedures did not detect.

***Likely Aggregate Misstatements***

Uncorrected misstatements aggregated during the audit that were determined by management to be immaterial amounted to \$209,038. The major unadjusted misstatements are as follows:

• Unrecorded revenue from prior year arena surcharges recognized in the current year	\$ (70,999)
• Overstated liabilities due to unsupported accruals	50,000
• Estimated doubtful accounts allowance not recorded	(72,000)
• Other small items	1,242
• Effect of 2008 items carried forward	(117,281)
Total Likely Aggregate Misstatement	\$ (209,038)

After considering both quantitative and qualitative factors with respect to the likely aggregate misstatements above, we agree with management that the financial statements are not materially misstated.



### Management Representations

During the course of an audit, management made many representations to us. These representations were verbal or written and therefore explicit, or they were implied through the financial statements. Management provided representations in response to specific queries from us, as well as unsolicited representations. Such representations were part of the evidence gathered by us to be able to draw reasonable conclusions on which to base the audit opinion. These representations were documented by including in the audit working papers memoranda of discussions with management and written representations received from management.

Management's representations included, but were not limited to:

- matters communicated in discussions with us, whether solicited or unsolicited;
- matters communicated electronically to us;
- schedules, analyses and reports prepared by the entity, and management's notations and comments thereon, whether or not in response to a request by us;
- internal and external memoranda or correspondence;
- minutes of meetings of the board of directors or similar bodies such as audit committees and compensation committees;
- a signed copy of the financial statements; and
- a representation letter from management.

We obtained management's written confirmation of significant representations provided to us during the engagement. Such a confirmation included matters that are:

- directly related to items that are material, either individually or in the aggregate, to the financial statements;
- not directly related to items that are material to the financial statements but are significant, either individually or in the aggregate, to the engagement; or
- relevant to management's judgments or estimates that are material, either individually or in the aggregate, to the financial statements.

### Our Audit Opinion

We did not detect any evidence of misstatements that would have a material effect on the consolidated financial statements and, accordingly, we have issued an unqualified audit report.



We wish to express our appreciation for the co-operation we received during the audit from the municipality's management. We would be pleased to discuss with you any matters mentioned in this letter, as well as any other matters that may be of interest to you.

Yours truly,

**BDO Canada LLP**  
Chartered Accountants, Licensed Public Accountants

A handwritten signature in black ink, appearing to read 'J Alex Richardson', written over a large, faint circular watermark or stamp.

J Alex Richardson, BA(Hons) CA  
Partner